

TESTIMONY OF KEN MCELDFOWNEY
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BEFORE THE PRESIDENT'S COMMISSION
ON THE UNITED STATES POSTAL SERVICE
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In recent years, the Postal Service has introduced a wide range of non-traditional retail and commercial products and services in an effort to generate additional revenues in anticipation of declining mail volumes.

Consumer Action is strongly opposed to the continued offering of such unauthorized products and services to the public absent the discipline that comes with classification and rate review. Such review would include the presentation of evidence and arguments to convince the Postal Rate Commission ("Commission") and intervenors that these new products and services meet the requirements of the Postal Reorganization Act ("PRA") and, most importantly, that they will, in fact, generate revenue. The current status of these services—imposing significant additional costs on monopoly and other postal ratepayers—is unconscionable and must be rectified by having the Commission exercise its regulatory authority over these products and services.

Nearly all of the Postal Service's e-commerce and other commercial ventures not reviewed by the Commission have involved large expenditures with near-zero revenues. The external discipline of preparing filings for proceedings would expose the large expenditures needed for the initiation of new products and services. Moreover, rates for new services could be set high enough so that startup, as well as operating costs, would be included in the rates set for proposed new services.

The Postal Service's failure to introduce these new services under the §§3622-23 regulatory framework is based upon its erroneous, unfounded interpretation of the PRA, particularly of §404(a)(6) which grants the Postal Service the power to establish nonpostal services. Congress never intended to invest the phrase "nonpostal services" with the broad meaning given it by the Postal Service.

In an October 15, 2002 "Request for Commission Review of Unclassified Services, CA and the Commission's Office of Consumer Advocate ("OCA") asked for the following:

- Review and determine that the fourteen challenged services are subject to the Commission's classification and rate jurisdiction under §§3622 and 3623.
- Establish stringent new accounting and reporting rules to ensure a complete separation of "non-jurisdictional (domestic)" costs and revenues from those of the jurisdictional service

The fourteen services challenged by CA and OCA are:

- 1) Liberty Cash
- 2) Sure Money
- 3) Online Payment Services (3 of them)
 - a. eBillPay
 - b. Pay @ Delivery
 - c. USPS Send Money
- 4) ePayments (unless this is the same as eBillPay)
- 5) NetPost CardStore
- 6) NetPost Certified Mail
- 7) Electronic Postmark
- 8) Unisite Antenna Program
- 9) Returns @ ease
- 10) Mall Package Shipment Program
- 11) First Class Phone Cards

12) Retail Merchandise

My testimony is largely based on the request to the Postal Rate Commission.

Consumer Action is a non-profit, membership-based organization founded in San Francisco in 1971. It serves consumers nationwide by advancing consumer rights, referring consumers to complaint-handling agencies through a free hotline, publishing educational materials in English, Spanish and several Asian languages including Russian and advocates for consumers in the media and before lawmakers, and compares prices on credit cards, bank accounts, and long distance services. CA distributes more than two million free publications annually in California and around the nation. CA conducts outreach with Community Advocates through a network of 6,500 community-based and government agencies. An advocacy department mobilizes support for pro-consumer legislation and access to financial and telephone services, and educates people on consumer issues. CA also aims to protect young children from preventable diseases caused by environmental hazards in San Francisco.

In recent years, the Postal Service has vainly made attempts to generate additional revenues by offering a variety of services and products through its Internet site, "usps.com," and in postal facilities throughout the nation. Many of these are hybrids of electronic and traditional mail services; still others are ancillary to the provision of traditional postal services or are equivalent to such services. Numerous investigations performed by the General Accounting Office ("GAO") at the request of Congress reveal that many of the Postal Service's e-commerce services operate at a substantial loss, generating large operating expenses but virtually no revenues. OCA discovery requests in the past two

omnibus rate cases have adduced evidence showing that the problem is even more acute than the GAO reports indicate.

Under directives from the Senate and the House of Representatives, GAO has presented numerous reports to Congress on the issue of nonpostal services generally, and e-commerce initiatives, specifically. The most recent of these reports, entitled an "Update on E-Commerce Activities and Privacy Protections," dated December 21, 2001, was submitted to Senator Thad Cochran, Ranking Member of the Subcommittee on International Security, Proliferation, and Federal Services. Among many damaging findings reported to Senator Cochran was that the Postal Service had projected revenues of \$104 million for its e-commerce initiatives in FY 2001, but had realized less than 1 percent in actual revenues by the end of the first three quarters. The Postal Service's tracking of the costs associated with these revenue projections are so seriously deficient that it is not possible to identify all of the costs caused by these services. GAO censured the Postal Service for failing to report the total planned costs associated with total planned revenues.

Planned advertising and program staff costs were not included in financial statements even for services whose costs were significantly comprised of such expenses. NetPostCertified and ePayments were among those services whose expenses were significantly understated. GAO was concerned that the Postal Service had neither developed reliable documentation on expenses related to information systems for e-commerce initiatives nor on infrastructure costs generally. Those concerns had not abated more than a year later

In response to interrogatory OCA/USPS-239 (the Postal Service lodged a partial objection and furnished a partial answer), the Postal Service reported that, since inception,

PosteCS had been offered at an operating loss of just over \$7 million. Its revenues were close to zero (\$8000). Electronic Postmark has been offered (since inception) at an operating loss of \$8.6 million, with revenues slightly above zero.

In response to interrogatory OCA/USPS-240, it was revealed that, under undisclosed Postal Service accounting procedures:

1. First-Class Phone cards yield a net operating income of \$30.1 million;
2. Retail merchandise generates a surplus of \$26 million;
3. Post Office Online lost \$28 million, without producing any revenue;
4. Dinero Seguro has lost a total of \$33.3 million since inception;
5. REMITCO lost \$10.1 million before it ceased operations; and
6. Sure Money has lost \$3.5 million, without generating any revenue.

In response to interrogatory OCA/USPS-241, the Postal Service stated that a family of online payment services it provides to the public, titled "USPS Online Payment Services," incurred operating expenses of \$11.5 million in FY 2001, but only took in \$1.1 million in revenues, thereby losing \$10.4 million in FY 2001. The Postal Service further explained that eBillPay, [Pay@Delivery](#), and USPS Send Money are included within the family of USPS Online Payment Services.

After summing the reported operating surpluses (for Phone Cards, Retail Merchandise, Liberty Cash, and NetPost Certified Mail) and the operating losses (for PosteCS, Electronic Postmark, PostOffice Online, Dinero Seguro, REMITCO, Sure Money, USPS Online Payment Services, and NetPost CardStore), an overall loss can be estimated based on the available figures for the entire array of "nonpostal" services (those listed above) of approximately \$44.5 million for the years 1995 to the spring of 2002.

CA and OCA were concerned that the losses may be far larger than the Postal Service's public disclosures indicate, for the Postal Service refuses to release to the Commission and intervenors information on the fixed and investment costs of providing these services. Using the three-year Mailing Online ("MOL") experiment as an example, investment costs for the hybrid internet/hardcopy service were projected, halfway into the experiment, to be approximately \$15 million, while the Postal Service has reported operating expenses for MOL at a little over \$11 million at the halfway point. Thus, the investment costs are running roughly one-third higher than the operating costs. It is reasonable to believe that the annual *operating* costs that the Postal Service is willing to disclose for similar e-commerce initiatives are also just the tip of the iceberg. Below the surface and out of sight there are likely to be additional tens of millions of dollars of information technology development costs that the Postal Service does not attribute to these services. In addition, it is not at all clear that the Postal Service attempts to identify and isolate those portions of operating costs that are incurred in common with jurisdictional services, but which are caused solely by the unauthorized services. Since there is no oversight by a regulator, it is likely that the Postal Service goes to little or no effort to root out and report the costs caused by unregulated services.

From GAO's reports it is evident that, absent regulatory oversight, the Postal Service's procedures for monitoring its non-jurisdictional domestic services have been, and continue to be, haphazard, inconsistent, and deficient.

The most recent GAO report (the December 2001 report to Senator Cochran) demonstrates that the Postal Service continues to exercise little internal control or oversight of its e-commerce:

- The management of the Postal Service's e-commerce program is fragmented and inconsistent.
- Required approvals of e-commerce initiatives are not always obtained; *some initiatives have been implemented before business plans were prepared or without business plan approval.*
- Financial information related to Postal Service e-commerce and internet-related activities is not complete, accurate and consistent.
- The Postal Service has difficulty even defining whether its Internet initiatives are e-commerce or not.
- There is no clear accountability or consistency in the development, approval, implementation, performance, and day-to-day monitoring of initiatives
- There has been a steady stream of organizational changes in the development and monitoring of e-commerce initiatives – the eBusiness Opportunity Board (eBOB) was set up in May 2000 to monitor these activities; a little over a year later (July 2001) a new approval process, "BizDev" was established through a new management group, Corporate Business Development (CBD); there was still another reorganization two months after that (September 2001) in which a new management group, Product Development, was established with responsibility for the e-commerce initiatives.

The most ominous implication for postal ratemaking is the substandard financial reporting for the e-commerce initiatives. Indeed, GAO not only identified significant deficiencies in the financial statements but also found inaccuracies in the data reported for e-commerce costs and revenues. In September 2000, GAO lacked confidence in the reliability of the Postal Service's financial reports. Even today, the Postal Service's financial statements fail to capture all of the revenues and costs associated with the e-commerce initiatives. The deficiencies of the Postal Service reports are numerous. As late as August 2001, the Postal Service had no system to attribute costs for the infrastructure

used to support e-commerce products and services. Without such an attribution system, the Postal Service is unable to identify common costs of e-commerce.

The remedy for most of the problems identified by GAO is Commission review and determination of the “postal service” nature of the allegedly “nonpostal” services and careful oversight of the Postal Service’s accounting and reporting for non-jurisdictional services.

For purposes of setting fees for the new classifications, “Rules Applicable to Requests for Changes in Rates and Fees,” *i.e.*, 39 C.F.R. §§3001.51–56, would govern. These rules would impose additional evidentiary requirements, such as the filing of accrued cost data, the assignment and distribution of costs, and econometrically developed volume estimates. Even under the rules for experimental changes, the collection and reporting of data is an essential element of the recommended decision to proceed.

Proceedings before the Commission typically involve detailed documentation rules for providing data, assumptions, and analyses that underlie the Postal Service’s filing of financial information. These are presented publicly and are subject to question and challenge, thereby tending to produce reliable, defensible outcomes. In this way, the Commission and the public can be assured that postal services are appropriately classified and rated and are not cross-subsidizing other services. The need for the Commission to exercise its regulatory oversight responsibilities over e-commerce initiatives and like services, subjecting Postal Service records to public scrutiny, is compelling.

Section 404(a)(6) grants to the Postal Service “specific powers” to “provide, establish, change, or abolish special nonpostal or similar services.” Thus, the Postal Service may establish, change, or withdraw the types of services listed in subsection

(a)(6). However, it is essential to observe that section (a)(6) is silent about the power to set a rate or fee for such services. Rates for such services (as for all domestic services sold by the Postal Service to the public) may only be established pursuant to §§3621 and 3622 of the PRA. “Nonpostal” services, as discussed below, have no rates associated with them. Rather, they involve a reimbursement arrangement between the Postal Service and governmental agencies for “public service” activities that the Postal Service provides on behalf of such agencies.

In only two places in the PRA has Congress delegated its power to set or change postal rates. The first is §407, in which it is stated, “The Postal Service, with the consent of the President . . . may establish the rates of postage or other charges on mail matter conveyed between the United States and other countries.” The second is a pair of sections, §§3621 and 3622, which authorize the Governors to establish reasonable and equitable rates of postage and fees for postal services (§3621), but only after the Postal Service requests that the Postal Rate Commission submit a recommended decision on “changes in a rate or rates of postage or in a fee or fees for postal services if the Postal Service determines that such changes would be in the public interest [§3622].” The only reasonable interpretation of these statutes is that Congress’ delegation of its power to establish rates and fees for postage and postal services is explicit and limited.

The Postal Service’s apparent construction of §404(a)(6) as a grant of the power to establish rates and fees for the challenged services is utterly without foundation. Therefore, the Postal Service’s retailing of these services to the public unilaterally, without a recommended decision by the Commission, constitutes *ultra vires* acts never authorized by Congress.

This understanding of the phrase “nonpostal services” is manifest throughout the legislative history of the drafting of the PRA. “Nonpostal services” had a precise meaning that was well known both to Congress and the Postal Service at the time the PRA was being drafted.

“Nonpostal services” were defined as: “[p]ublic service costs associated with non-reimbursed services for other government agencies.” Therefore, at the time that Congress drafted §§404 and 3621-3623 of Title 39, it was well understood that “nonpostal” services were services performed on behalf of other government agencies. Examples of “nonpostal” services were: health services for the Federal Communications Commission, alien address reporting, sale of U.S. savings bonds, services performed for the Civil Service Commission, sale of migratory bird stamps, building services for other federal agencies, and transportation of military mail. Non-mail, commercial services offered to the general public were never included in the legislative history discussing the phrase “nonpostal” services during the crucial period of statutory debate and development.

If Congress had intended to delegate to the Postal Service the power to engage in virtually any kind of enterprise that it liked, and set fees at any level that the Postal Service chose, from zero to exorbitant, it is certain that there would have been extended discussion in the legislative history indicating such an intent. One wonders whether the Postal Service sees any limitation on its ability to sell services and products to the public under §404(a)(6) – could the Postal Service sell used cars if it chose? Open up a chain of fast food restaurants? Operate a bowling alley?

In addition to viewing itself as having unlimited power to engage in any type of commercial enterprise, the Postal Service believes that there are no restrictions on its

power to set rates for such products and services at any level it chooses, even if this means using monopoly revenues to drive competition out of the market. It is almost a certainty that Congress never intended to give the Postal Service unbridled power to misuse its monopoly privilege to eliminate competition in any commercial arena it chooses. If this were Congress' intention, where in the legislative history are these intentions stated? The answer, of course, is that Congress never articulated such an intention and has not granted to the Postal Service the powers that it has unlawfully arrogated to itself.

Of further significance, these services are often offered for sale in competition with other similar or equivalent services sold by private enterprises. The PRA at §3622(b)(4) directs that Commission rate recommendations shall consider the effect of rate increases upon private enterprises engaged in the delivery of mail matter other than letters. Congress' explicit concern about the impact of postal service rates upon private enterprises suggests that it is important to consider whether the service impacts private enterprises. If it does, this suggests it is the type of service Congress wanted the Commission to regulate. By contrast, nonpostal services, as Congress understood them, involve only non-reimbursed services for other government agencies and do not compete with private enterprises. In summary, the only rational construction of the PRA is that, while the Commission does not have jurisdiction over "nonpostal services," *i.e.*, the public services performed by the Postal Service on behalf of other government agencies, it does have jurisdiction over the services cited in this letter. The fundamental character of jurisdictional services is their nexus with the movement of mail: they are provided in connection with, or ancillary to, the movement of mail or are the functional equivalent of

mail. The other significant criterion for jurisdiction is that they are sold to the public for a fee (or will be at a future time) – a feature true of all of the services challenged in this letter.

It is reasonable to conclude that the services challenged here are subject to Commission regulation as postal services under chapter 36. All of the above discussion provides ample grounds for the Commission to commence a classification proceeding to investigate thoroughly the characteristics and terms of each challenged service. In this way, the “postal” status and the impact upon other postal services may be determined for each listed service, taking into consideration, *inter alia*, the effect upon private enterprises engaged in the delivery of mail matter other than letters.

In a rate proceeding affecting jurisdictional postal services under §§3621, the Commission is obligated to set rates and fees that will generate sufficient revenues to permit the Postal Service to achieve a “break even” financial result. This is not possible in the absence of reliable estimates of revenue and expense for non-jurisdictional services; the Commission cannot determine how much net revenue must be raised by jurisdictional mail services to allow the Postal Service to break even. Consequently, the Commission should require the Postal Service to provide an accurate accounting of the revenue generated by each non-jurisdictional service. A concomitant requirement should be an accurate accounting of the volume (or number of transactions) for each non-jurisdictional service.

With respect to costs, in the context of international postal services, the Commission has stated that “the mandate of §3622(b)(3) that each mail service bear its own direct and indirect cost requires that the Commission ensure that no cost properly attributable to international mail is inadvertently assigned to domestic mail.” This same

obligation is required of the Commission with respect to domestic non-jurisdictional services. Such non-jurisdictional services incur costs that are not caused by domestic mail services. These include, in the case of non-jurisdictional e-commerce initiatives, costs of processing electronic financial payments. They might also include costs incurred exclusively to manage non-jurisdictional services. At the present time, costs for certain non-jurisdictional services are not complete, accurate or consistently reported. For example, it appears highly unlikely that all of the costs caused by the sale of retail merchandise by a postal window clerk have been allocated to the non-jurisdictional service. At a minimum, costs exclusive to non-jurisdictional services must be reliably identified so as to permit verification of the proper allocation between jurisdictional and non-jurisdictional services.

It is essential that the Postal Service collect and report cost data permitting application of the incremental cost test for non-jurisdictional services. The incremental cost test must be performed to determine whether non-jurisdictional services generate sufficient revenues to be free of cross-subsidy. Even the Postal Service agrees, in principle, that “eCommerce products and services in the aggregate are to cover the incremental costs and thus not be cross-subsidized.” However, permitting the Postal Service to satisfy the incremental cost test in the aggregate for non-jurisdictional services rather than individually may permit cross-subsidy among some non-jurisdictional services. Consequently, the Commission should require sufficient cost data and documentation to permit application of the incremental cost test for non-jurisdictional services in the aggregate, for each individual non-jurisdictional service, and for each group of such services.

Since many so-called nonpostal services have generated significant losses over the last several years, there is a distinct possibility that in an omnibus rate proceeding, the prior year losses that the Postal Service requests be included as part of the institutional costs in the rates for jurisdictional ratepayers improperly include losses associated with non-jurisdictional services. Therefore, the Postal Service must be required to submit evidence in an omnibus case that permits the separation of past jurisdictional losses from past non-jurisdictional losses.

Following is a preliminary proposal for an amendment to Commission Rule 54(h)(1) that specifies the contents of formal requests in §3622 proceedings. The language is intended to ensure that the Commission will obtain from the very inception of rate proceedings all of the developmental, investment, and operating costs relating to all services offered by the Postal Service. The proposed language would follow the last sentence of current Rule 54(h)(1):

- (i) The following must be provided for domestic services offered to the public outside of a Commission recommendation under 39 U.S.C. §§3622 and 3623: a complete listing of all such services that the Postal Service offers to the public for a fee or intends to offer for a fee. For each such non-jurisdictional service, the Postal Service shall provide a full description of the elements of the service.
- (ii) For each such non-jurisdictional service, the Postal Service shall describe and provide in full detail all of the costs incurred in providing the service, including all related investment costs and whether these costs are incurred solely for the non-jurisdictional service or in common with other services (whether jurisdictional or non-jurisdictional).
- (iii) For each such non-jurisdictional service, the Postal Service shall provide the operating costs of the non-jurisdictional service and a description of the operations producing the operating costs. For each such non-jurisdictional service, the Postal Service shall state which operating costs are incurred separately from other services and which are incurred jointly. The Postal Service shall explain fully how jointly incurred costs are allocated among the services (both jurisdictional and non-jurisdictional) involved.

(iv) For each such non-jurisdictional service the Postal Service shall provide the development, start-up, and all other investment costs for the service beginning with the time that the Board of Governors first approved (whether formally or tacitly) the provision of the service to the public or a segment of the public (including on a pilot or test basis). Development and start-up costs shall include all of the costs to develop the non-jurisdictional service and shall be reported on a fiscal year basis. The Postal Service shall state how development and start-up costs are being recovered from fees charged for the non-jurisdictional service. If development and start-up costs can not be recovered fully from the non-jurisdictional service, then the Postal Service shall state how the costs will be recovered from other services (whether jurisdictional or non-jurisdictional).

(v) The Postal Service shall report any other costs caused by provision of the non-jurisdictional service. Each cost-causing activity or material underlying such costs shall be described. The portion of such cost involved solely in the provision of the non-jurisdictional service shall be provided. The portion of such cost that is incurred jointly with other services shall also be provided. The Postal Service shall show all details in allocating jointly incurred costs among those services (whether jurisdictional or non-jurisdictional) that causes them.

(vi) Amounts proposed by the Postal Service for the recovery of prior year losses shall separate those losses produced by jurisdictional services and those generated by non-jurisdictional services. Any losses generated by non-jurisdictional services may not be made part of the costs to be recovered by jurisdictional rates and fees.

(vii) Workpapers reflecting the estimation and calculation of each type of cost listed above shall be provided. Upon request by the Commission or a participant, primary data and source material underlying cost estimates and calculations shall be provided.

A second amendment, to Rule 54(k)(1), is also submitted as a preliminary proposal.

We propose that the following subsection “(v)” be added just after subsection “(iv)

Statement of Income and Expense by cost segment:”

For each non-jurisdictional service listed in conformance with Rule 54(h)(1), a Balance Sheet and a supporting schedule for each item appearing thereon; and a Statement of Income and Expense and a supporting schedule for each item appearing thereon shall be provided.

CONCLUSION

The Postal Service's decision not to request, initially, Commission classification and rate review of its new services has created a gap in the system of regulation that Congress never intended with the enactment of the PRA. By its failure to establish and enforce procedures for approving and monitoring the performance of new services, Postal Service management has abdicated its role in protecting the public interest in the provision of such services. Further failures to develop adequate accounting and reporting procedures for non-jurisdictional services risk unlawful cross-subsidy by jurisdictional services. The need for the Commission to exercise regulatory oversight is compelling.

The Commission should institute a classification and rulemaking proceeding to end the unauthorized provision of retail services and promulgate accounting rules that will ensure that jurisdictional ratepayers do not have included in their rates the expenses and losses of non-jurisdictional services.